IN THE UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT
HARTFORD DIVISION

In re:	)	Chapter 11
JOHNSON MEMORIAL MEDICAL CENTER, INC., et al.,[1]	)	Jointly Administered under Case No. 15-20056 (ASD)
Debtors.	)	

OBJECTION OF THE PENSION BENEFIT GUARANTY CORPORATION TO MOTION OF JOHNSON EVERGREEN CORPORATION, PURSUANT TO BANKRUPTCY CODE SECTIONS 105, 363 AND 365 AND BANKRUPTCY RULES 2002, 6004 AND 6006, FOR (I) AN ORDER (A) APPROVING BIDDING PROCEDURES AND BIDDER PROTECTIONS IN CONNECTION WITH THE SALE OF SUBSTANTIALLY ALL OF ITS ASSETS, (B) APPROVING PROCEDURES FOR THE ASSUMPTION AND ASSIGNMENT OF CERTAIN EXECUTORY CONTRACTS AND UNEXPIRED LEASES IN CONNECTION THEREWITH AND (C) SCHEDULING A FINAL SALE HEARING AND APPROVING THE FORM AND MANNER OF NOTICE THEREWITH; AND (II) AN ORDER (A) AUTHORIZING THE SALE OF SUBSTANTIALLY ALL OF ITS ASSETS, FREE AND CLEAR OF LIENS, CLAIMS, INTERESTS AND ENCUMBRANCES AND (B) GRANTING CERTAIN RELATED RELIEF

The Pension Benefit Guaranty Corporation ("PBGC"), a secured creditor against the Seller Debtor, hereby files this objection to the above-mentioned Motion filed on January 15, 2015, Case No. 15-20062-ASD, (Docket No. 18).[2] The Motion seeks, among other things, approval of proposed bid procedures to facilitate the sale of the Seller Debtor's assets, with Saint

[1] Johnson Memorial Medical Center, Inc., Case No. 15-20056, Johnson Memorial Hospital, Inc., Case No. 15-20057, Home & Community Health Services, Inc., Case No. 15-20060, Johnson Health Care, Inc., Case No. 15-20061, The Johnson Evergreen Corporation, Inc., Case No. 15-20062, Johnson Professional Associates, P.C., 15-20063.

[2] PBGC reserves all rights to supplement this objection and/or to file an additional objection to the approval of the sale sought in the Motion at a final hearing to be set by the Court.

Francis *Care,* Inc. ("Saint Francis") as the stalking horse bidder.[3] Various terms in the bid procedures will effectively chill the bidding process and should not be approved.[4]

First, the stalking horse bidder's proposed purchase price is unknown. With no purchase price, potential bidders have no idea what the amount of the Initial Bid Increment should be. The bid procedures also require that any Competing Bid exceed Saint Francis' proposed purchase price by $50,000.00 plus the Break-Up Fee ($50,000.00). Without a purchase price, there is no way to adequately analyze whether the Break-Up Fee is excessive and unreasonably inflates even further the Initial Bid Increment. The Initial Bid Increment is already unreasonably inflated because there is no justification for including the $50,000.00 cash in addition to the Break-Up Fee. The bid procedures also improperly require double payment of the Break-Up Fee – once in the Initial Bid Increment and again in any overbid against Saint Francis.

Second, to constitute a Competing Bid, the bid must propose to conform to the terms of the stalking horse purchaser's Asset Purchase Agreement ("APA"). This is unreasonable because, not only is the APA incomplete so as to make it impossible for prospective bidders to submit a Competing Bid, but a prospective bidder may wish to offer a higher, all-cash bid but do so outside the framework of the APA. And, the APA violates the absolute priority rule because it fails to allocate any sale proceeds to PBGC's secured claims. Third, the bid procedures do not provide potential purchasers sufficient time to conduct the due diligence necessary to submit a Competing Bid. Finally, the bid procedures provide no assurance of time to adequately conduct a marketing process prior to the auction. These flaws in the bid procedures will substantially harm creditors because they will have a chilling effect on, if not prevent altogether, prospective

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[3] The Seller Debtor is the Johnson Evergreen Corporation ("JEC").

[4] Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Motion and Exhibits.

bidders and decrease competition at auction. Thus, the Court should not approve the proposed bid procedures without first requiring the Seller Debtor to make certain modifications described herein.

I. BACKGROUND

A. PBGC and ERISA

PBGC is a wholly-owned United States government corporation, and an agency of the United States, that administers and enforces the defined benefit pension plan termination insurance program under Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA"). *See* 29 U.S.C. §§ 1301-1461 (2012). PBGC guarantees the payment of certain pension benefits upon the termination of a single-employer pension plan covered by Title IV of ERISA. When an underfunded plan terminates, PBGC generally becomes trustee of the plan and supplements any assets remaining in the plan with its insurance funds to pay to the retired employees their pension benefits, subject to statutory limits. *See* 29 U.S.C. §§ 1321-1322, 1342, 1361. PBGC's insurance funds are made up of, among other things, (i) the agency's recoveries of terminated pension plan's underfunding and (ii) premiums paid by pension plan sponsors.

Also, when an underfunded pension plan terminates, the plan sponsor and its controlled group members are jointly and severally liable to PBGC for the pension plan's underfunding, which is the value of the benefit liabilities owed to all participants and beneficiaries under the plan over the value of the plan's assets, as of the termination date, together with interest thereon. *See* 29 U.S.C. §§ 1301(a)(18), 1362. The rate of interest is the rate prescribed in 29 C.F.R. § 4062.7(c).

B. The Pension Plan

Johnson Memorial Hospital ("JMH") sponsored the Retirement Plan for Employees of Johnson Memorial Hospital ("Pension Plan" or "Plan"), a single-employer defined benefit pension plan covered under Title IV of ERISA.

On March 3, 2010, PBGC received a distress termination application, seeking to terminate the Pension Plan. On September 1, 2011, PBGC and the Pension Plan's administrator entered into an Agreement for Appointment of Trustee and Termination of Plan whereby (i) the Pension Plan was terminated pursuant to 29 U.S.C. § 1341(c); (ii) April 30, 2010 was set as the Plan's termination date; and (iii) PBGC was appointed as statutory trustee of the Pension Plan. The Pension Plan covered approximately 834 of JMH's employees and was underfunded by $33,459,436.00. Now, upon retirement, those employees look to PBGC for the payment of their benefits under the Pension Plan, subject to statutory limits.

Upon termination of the Plan, JMH and members of its controlled group, which include the Seller Debtor, became jointly and severally liable for the Plan's underfunding, unpaid contributions owed to the Plan and unpaid premiums owed to PBGC ("Pension Liabilities"). Settlement of the Pension Liabilities was memorialized in a court-approved Plan of Reorganization in the 2008 Chapter 11 Bankruptcy case.

C. Seller Debtor's Bankruptcy Proceedings and Proposed Bid Procedures

On January 14, 2015, the Seller Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. PBGC holds secured claims totaling $5,158,720.23 from the 2008 Chapter 11 bankruptcy.[5]

[5] Seller Debtor's assertion that it owes approximately $6,000,000.00 to PBGC and the unsecured creditors from the 2008 bankruptcy case combined (Motion ¶16, e) is inaccurately low.

On January 15, 2015, the Seller Debtor filed the Motion. PBGC objects to the Motion in that the proposed bid procedures will chill other bidding and should not be approved.

ARGUMENT

When selling estate assets, a debtor has a duty to obtain the highest price or greatest overall benefit possible for the estate. *See In re Integrated Res., Inc.*, 147 B.R. 650, 659 (S.D.N.Y. 1992) (citing *In re Atlanta Packaging Prods., Inc.,* 99 B.R. 124, 130 (Bankr. N.D. Ga. 1988)). To that end, "it is the overarching objective of sales in bankruptcy to maximize value to the estate." *In re Metaldyne Corp.*, 409 B.R. 661, 667-8 (Bankr. S.D.N.Y. 2009).

1. **The proposed bid procedures will chill bidding because they fail to specify the proposed purchase price.**

The APA states that the purchase price consists of (i) Assumed Liabilities and (ii) amounts equal to or assumption of certain obligations.[6] But, there are no liquidated amounts for all of the Assumed Liabilities and obligations – so that it is impossible to determine the exact amount of Saint Francis' proposed purchase price. Without a purchase price, a potential bidder has no way of determining an Initial Bid Increment. It is also impossible to determine whether the Break-Up Fee is excessive. Excessive fees would chill bidding by inflating the Initial Bid Increment and Saint Francis' ability to credit bid the Break-Up Fee.[7]

a. The Break-Up Fee, which is a percentage of the purchase price, may exceed the amount typically approved by courts in the Second Circuit.

Bidding incentives such as break-up fees are "carefully scrutinized" in asset sales under Bankruptcy Code § 363(b) because bidding incentives impose expenses on the debtor's estate,

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[6] *See* Motion, Exhibit A – Asset Purchase Agreement, ¶ 1.6.

[7] *See* Motion, Exhibit B – Bid Procedures Order, Exhibit 1 – Bid Procedures, p.17, "Right to Credit Break-Up Fee."

affecting the debtor, creditors, and equity holders alike. *In re Integrated Res., Inc.*, 135 B.R. 746, 750-51 (Bankr. S.D.N.Y. 1992), *affirmed by*, 147 B.R. 650 (S.D.N.Y. 1992).

In reviewing break-up fees, courts in the Second Circuit have considered, inter alia, whether (i) the fee hampers, rather than encourages, bidding; and (ii) the amount of the fee is unreasonable relative to the proposed purchase price. *In re Integrated.*, 147 B.R. at 657. In assessing the incentive effect of a break-up fee, a court should determine whether the amount of the fee has a "chilling effect" on other prospective bidders. *Id*. at 660. In making this determination a court should consider whether the proposed buyer will attract other bidders or simply receive a potential windfall. *Id*. While break-up fees and other strategies may be necessary to encourage a stalking horse purchaser to enter the bidding, such strategies are inappropriate if it is known that bidding would cease as a result of them. *Id*.

Additionally, courts must consider whether a break-up fee is "reasonable in relation to the bidder's efforts and to the magnitude of the transaction." *In re 995 Fifth Ave Assocs.*, 96 B.R. 24, 28 (Bankr. S.D.N.Y. 1989) (internal citation omitted).

Here, the Seller Debtor seeks a Break-Up Fee for Saint Francis in the total amount up to $50,000.00.[8] Because the Motion and APA are silent as to the purchase price, it is impossible to determine whether the proposed Break-Up Fee is commensurate with the amount generally approved by courts in this Circuit. *See In re Golfers' Warehouse, Inc.*, 2009 Bankr. LEXIS 5141, at *6 (Bankr. D. Conn. July 14, 2009) (approving a breakup fee under 3.5% referenced in the debtor's Asset Purchase Agreement); *In re Metaldyne Corp.*, 409 B.R. at 670 (approving a break-up fee and expense reimbursement of less than 3% of the total purchase price); *In re Jon J.*

[8] *See* Motion, Exhibit B – Bid Procedures Order, Exhibit 1 – Bid Procedures, p. 13.

Peterson, Inc., 411 B.R. 131, 138 (Bankr. W.D.N.Y. 2009) (limiting the break-up fee to 0.46%, representing the costs and reasonable expenditures of the stalking horse offer).

This Court should not approve the Break-Up Fee in the proposed amounts without knowing the purchase price. The bid procedures and APA should be modified to state the liquidated amount of Saint Francis' proposed purchase price. And the amount of the Break-Up Fee should be less than 3.5% of that purchase price.

It is critical to prevent an excessive Break-Up Fee because any Initial Bid Increment must exceed Saint Francis' proposed purchase price by the sum of the Break-Up Fee and an additional $50,000.00. Thus, a reasonable Break-Up Fee will ensure that the Initial Bid Increment required to participate in the auction will be set at the lowest necessary amount. Also, an excessive Break-Up Fee would also make it more difficult for potential bidders to compete with Saint Francis, who is the only potential buyer that can credit bid the Break-Up Fee.[9] By ensuring that the Break-Up Fee is set at an amount approved by this Circuit, it will ensure the likelihood of competitive bidding on the Seller Debtor's assets and maximize recoveries to the bankruptcy estates and creditors.

b. The bid procedures improperly require, in the Initial Bid Increment, $50,000.00 in addition to the Break-Up Fee and then a duplicate payment of the Break-Up Fee in subsequent overbids.

The Initial Bid Increment requires payment of $50,000.00 plus the Break-Up Fee. Then, the Break-Up Fee must be paid again in any subsequent overbid against Saint Francis. The bid procedures state that:

> after such Initial Bid Increment, all further overbids must be in increments of at least $50,000; provided, further, that if such overbid is made against a bid last made by [Saint Francis], then such overbid must be at least $50,000 more than such [Saint Francis'] bid plus the Break-Up Fee in cash ($50,000), and the Debtor

[9] *See supra* n.7.

shall, in its discretion, have determined that such overbids satisfy such bidding increment requirement.[10]

The $50,000.00 initial payment and the double payment of the Break-Up Fee would discourage, if not prevent altogether, any other bidding and would only result in a windfall to Saint Francis.

Chilling prospective bids will not maximize the sale of the Seller Debtor's assets, which in turn will not maximize the creditors' recovery on their claims. Accordingly, the excessive and duplicative payment of the Break-Up Fee could have a substantially adverse impact on PBGC and possibly the employees who participate in the Pension Plan.

2. **The proposed bid procedures will chill bidding because they require all Competing Bids to conform to the terms of the APA, but such terms have not been finalized and the APA violates the absolute priority rule.**

The proposed bid procedures require a potential bidder to offer terms no less favorable to the Seller Debtor than those set forth in the APA, agree to provide services equivalent to those provided by Saint Francis as defined by the APA, agree to offer employment to the Seller Debtor's employees as provided in the APA and adhere to all licensing restrictions of the current facility and operation.[11]

a. The APA has not been finalized.

The APA does not provide a detailed listing of all employment requirements currently held by Seller Debtor. The permits and licenses listed in Schedule 1.2(d), which any potential buyer is required to assume, provide no actual substance of what each requires. Furthermore, Schedule 1.2(h) to the APA, listing "Assumed Contracts," merely states "The Evergreen Ground Lease" and "Other Assumed Leases and Contracts to be determined by the Buyer prior to

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[10] *See* Motion, Exhibit B – Bid Procedures Order, Exhibit 1 – Bid Procedures, p.13.

[11] *See id.* at pp.12-13.

Closing pursuant to Section 10.5 of the Agreement." This all further underlines the fact that Seller Debtor does not list the actual purchase price of the sale.

The proposed bid procedures will chill bidding because they require a potential bidder to commit to the purchase of assets and assumption of contracts that have not been adequately defined under the APA and which have no defined purchase price. No potential bidder could – or should be expected to – make such a blind commitment. The Seller Debtor and Saint Francis must finalize the APA by detailing all assets, licenses, contracts, leases, and liabilities to be assumed by Saint Francis with accuracy and specificity before the bid procedures can be approved by this Court. This is necessary to remove ambiguity from the bidding and auction process and to help facilitate an environment where potential bidders are drawn to participate.

Furthermore, the Bid Procedures should not require that a Competing Bid purchase the same assets and assume the same contracts and liabilities as the stalking horse bidder. It is possible that a prospective bidder may wish to offer a creative alternative bid that does not mirror Saint Francis' in form and substance. Otherwise, the bid procedures will certainly chill the bidding process by turning away prospective bidders.

b. The proposed APA to the Bid Procedures fails to allocate any of the sale proceeds to PBGC, a secured creditor.

Section 1.6(b) of the APA provides how and to whom the payment of the sale proceeds should be allocated.[12] The allocation does not include payments to PBGC (and the Plan Administrator, whose secured claims are *pari passu* with the PBGC).[13] The APA's failure to allocate payment for ***any*** of PBGC's secured debt is improper and contrary to the Bankruptcy Code's absolute priority rule. *See* 11 U.S.C. § 1129(b)(2)(A).

[12] *See* Motion, Exhibit A – Proposed Asset Purchase Agreement, ¶1.6(b).

[13] *See id*.

3. **The proposed bid procedures will chill bidding because they do not provide assurances that potential purchasers will have adequate time to conduct their due diligence.**

As stated above, the bid procedures require a potential bidder to adopt the terms of the APA in order to participate in the auction – even though the APA is incomplete. Nevertheless, the bid procedures provide potential bidders with no set amount of time after the Court enters the order approving the bid procedures to conduct their due diligence and submit a Competing Bid. Given the lack of clarity with respect to what assets, contracts, and liabilities the stalking horse bidder is purchasing and assuming, it is unreasonable that bidding procedures should be approved without assurance that a potential purchaser could conduct the due diligence necessary to complete a deal within a timeframe established by the bidding procedures.

The bid procedures must provide prospective bidders with at least 90 days to conduct due diligence. Even Saint Francis, who has been negotiating with the Seller Debtor for ***years***, has not yet finalized its offer, as evidenced by the incomplete APA that was filed with the Motion. The APA also implies that Saint Francis conducted extensive, time consuming due diligence.[14] It is therefore reasonable to assume that prospective bidders will need to do the same. The bid procedures should therefore afford parties time to complete their due diligence.

4. **The proposed bid procedures chill bidding because they fail to provide a reasonable time period for Debtor to market the property.**

One way that a debtor can maximize value for the estate through an asset sale is to conduct a proper marketing campaign to ensure that the highest price is obtained for the assets. But, the bid procedures do not require or afford any time for the Seller Debtor to conduct any sort of meaningful marketing of its assets. It appears no marketing of the Seller Debtor's assets

[14] *See* Motion ¶30.

occurred since the 2008 Chapter 11 Bankruptcy, and the Motion does not provide any provisions for how marketing will occur going forward.

Seller Debtor asserts that "[b]ecause of the nature of Seller Debtor's business, the market of potential buyers for their assets is limited."[15] It is unreasonable for the Seller Debtor to speculate that a group of potential purchasers will not be interested in the business without actually testing the market, and to then proceed without a clear plan for marketing the sale. Given that the Seller Debtor's efforts to market the business thus far are insufficient at best, the bid procedures' lack of a reasonable timeframe for the auction is unacceptable. The bid procedures should therefore provide sufficient time for the Seller Debtor to market the assets appropriately. If not, the bid procedures will stifle interest in the Seller Debtor's assets, decrease the pool of potential bidders, chill bidding, and, in turn, harm the interests of creditors in this bankruptcy proceeding.

III. CONCLUSION

This Court should not approve the bid procedures because they will chill bidding, fail to maximize value of the estate, and cause substantial harm to creditors. Instead, the bid procedures must be modified before they can be approved by this Court.

First, the Seller Debtor must provide the actual purchase price. Once Seller Debtor has provided this figure, the Seller Debtor must demonstrate that the Break-Up Fee is at an amount acceptable in this Circuit and eliminate the double payment of the Break-Up Fee in any overbid. And, the $50,000.00 in the Initial Bid Increment should be eliminated. The APA should be finalized so that it details all obligations being purchased or assumed by Saint Francis with specificity and clarity before the Seller Debtor begins soliciting Competing Bids. The APA

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[15] *See* Motion, ¶38.

should allocate payment to PBGC's secured claims. The bid procedures should allow potential purchasers adequate time to properly conduct the due diligence necessary to submit a Competing Bid. Finally, the bid procedures should be modified to allow the Seller Debtor adequate time to properly market the assets for sale.

DATED: February 12, 2015
Bridgeport, CT

Respectfully submitted,

/s/ Jared S. Wiesner
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UNITED STATES BANKRUPTCY COURT
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	)	
JOHNSON MEMORIAL MEDICAL CENTER, INC., et al.,[1]	)	Jointly Administered under Case No. 15-20056 (ASD)
Debtors.	)	

CERTIFICATE OF SERVICE

This is to certify that a copy of the Objection of the Pension Benefit Guaranty Corporation to Motion of Johnson Evergreen Corporation, pursuant to Bankruptcy Code Sections 105, 363 and 365 and Bankruptcy Rules 2002, 6004 and 6006, for (i) an Order (a) Approving Bidding Procedures and Bidder Protections in Connection with the Sale of Substantially All of Its Assets, (b) Approving Procedures for the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases in Connection Therewith and (c) Scheduling a Final Sale Hearing and Approving the Form and Manner of Notice Therewith; and (ii) an Order (a) Authorizing the Sale of Substantially All of Its Assets, Free and Clear of Liens, Claims, Interests and Encumbrances and (b) Granting Certain Related Relief has been served electronically, this 12th day of February 2015, via CM/ECF to all parties registered to receive electronic service.

/s/ Jared S. Wiesner
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Attorney

[1] Johnson Memorial Medical Center, Inc., Case No. 15-20056, Johnson Memorial Hospital, Inc., Case No. 15-20057, Home & Community Health Services, Inc., Case No. 15-20060, Johnson Health Care, Inc., Case No. 15-20061, The Johnson Evergreen Corporation, Inc., Case No. 15-20062, Johnson Professional Associates, P.C., 15-20063.